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Anderson, Benjamin McAlester

Price readjustment

[New York]

[1918]

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Price Readjustment

By

B. M. ANDERSON, JR.

National Bank of Commerce
in New York

DECEMBER, 1918

Foreword

Liquidation of war conditions as promptly as consistent with the fulfillment of our purpose in the war, is highly to be desired so that business may return to a basis of peace and the realization of legitimate profits. It is the aim in the following discussion of price control to aid business men to a clearer view of conditions resulting from the return of peace. The stand is taken that the business changes involved in this transitional period should be allowed to follow their normal course, and that they should not be subjected to artificial influences.

The fact that commodity prices and wage rates will decline need not mean great impairment of profits in efficiently conducted industry. The margin of possible savings between business as conducted under the hurry of war needs and as conducted under the keen competition of peace, is wide. The period when any enterprise could get a contract for the asking and every laborer had several jobs open to him is over and already the disposition is manifest on the part both of employers and of laborers to watch costs, cut down waste and increase efficiency. This is a factor that should absorb much of the shock of falling prices.

The discussion in the following pages is a further development of our booklet, "When Prices Drop," published in November.

JAMES S. ALEXANDER,
President.

16 March, 1920 - C.R.W.

Price Readjustment

By

B. M. Anderson, Jr., Ph. D.
of the
National Bank of Commerce in New York

Price-fixing in this country has served its purpose and should be abandoned at the earliest possible date. It was a temporary subversion of principles of free enterprise that only the war emergency justified. But like press censorship and other necessary measures incompatible with the genius of American institutions, it should be done away with. A medicine in war, it would prove a poison in peace. There may remain, for a few months, good reasons for a continuance of price-fixing in specially scarce foods, as normal food conditions must await new harvests in Europe. But permanent price-fixing is no more to be desired than is a permanent standing army of four million men.

A New Kind of Price-Fixing

Particularly unsound is the form of price-fixing for which a demand has arisen in some quarters—a demand for nothing less than price-fixing designed to keep prices up against the inevitable drop that will come with the return to conditions of peace. The notion that prices should be kept up is based on the fallacy that a fall in prices is undesirable. The fact is that a drop in prices to stable levels is exactly what is desired. Such stable levels are prerequisite to satisfactory business conditions.

Price-fixing is only one of several plans suggested by those who are apprehensive as to the effects of falling prices on business. It has

been proposed to prevent the fall in prices: (a) by price-fixing; (b) by a continuance of heavy loans by the United States Government to our Allies, to be used for *reconstruction purposes;* and (c) by an organized policy of liberal lending on the part of American banks.

Fall in Prices Desirable

Two comments are in order. In the first place, these policies, while they might for a time retard the fall in prices, could not prevent it. In the second place, it is better by far to have our prices go down in natural course, get through with it, and then undertake long-time plans on a sound price-basis.

The efficacy of the measures suggested for preventing a fall in prices is essentially limited. (a) Price-fixing, for example, has not been devised for holding prices *up*, but for holding them *down*. We have devised no machinery for holding prices up except in the case of wheat, where the purpose was to make the maximum price also a minimum price, and where the Government has created the Grain Corporation with a "revolving fund" of $150,000,000 which may be used in purchasing wheat if the market price should fall below the minimum guarantee. But, in general, our price-fixing mechanism has been adjusted to hold prices down, and the procedure has been essentially this: As we have limited prices, we have restricted consumption, rationing out the supplies. We have said to producers: "Produce all you possibly can," but we have said to consumers, "You may buy at such and such price, but you may only buy so much" and to some consumers, we have said, "You may not buy at all."

The Government organization concerned with handling this problem has been worked out with a view to studying the needs of consumers, and to rationing the supplies in accordance with public policy.

It would, of course, be possible to reverse the procedure, and to make the present maximum prices minimum prices. But in that case, we should have also to reverse our instructions to producers and consumers. We should then say to consumers, "Buy all you possibly

can," but we should have to say to producers, "Although you may sell at such and such a price, you must restrict production and limit output. If you sell at a high price you can only sell such and such amounts."

Artificial Price Levels

This procedure is, indeed, not unfamiliar in the history of American business. We have had pools and combinations in the past which, by restricting output, have sought to maintain prices. But such pools have not usually been successful. The temptation to expand the market by breaking the pool agreement and cutting prices has always been a great one. Moreover, such arrangements are clearly contrary to public policy. Whatever else we may seek to do in the present emergency, we must do nothing which would tend to lessen output. The world is impoverished, goods and supplies of all kinds are short, and every effort should be bent toward increasing supplies.

We need not give serious consideration to the idea that a more legal *fiat*, naming a price at which men shall buy and sell, would be efficacious. Price-fixing, to the extent that it has been successful during the war, has been successful only by virtue of a control and rationing out of the supplies. Price-fixing as a permanent policy is indefensible in any case. The magnificent loyalty of the American business man, and the heavy pressure of public opinion under the stimulus of the war, have made business men submit to it as a temporary measure. But it would do great harm if long continued.*

Loans To Allies For Reconstruction

(b) While it is desirable that our Government should continue to make necessary loans to our Allies to enable them to meet war time problems, and while it may be desirable that loans to our Allies even for reconstruction purposes should be made directly by the Government, it is neither desirable that such loans be made in large volume

*See the present writer's paper, "Value and Price Theory in Relation to Price-fixing and War Finance," American Economic Review, Supplement, March, 1918.

to be spent on reconstruction materials at present prices, nor probable that they will be. A factory, built at present prices of building materials and machinery, would be handicapped in competition with a factory built a little later, when building materials and machinery have gone down. A French business man, making a fixed investment which is to bring in returns during a twenty to twenty-five-year period, would not be enthusiastic about using credits, even if unlimited credits were offered him by his government, on the present level of prices. He will feel it wiser to wait till prices fall; and the quicker prices fall, the sooner will he begin his operations.

The world has been forced to reckless buying by the emergencies of the war, and whatever was necessary for carrying on the war, the governments have bought. Civilization itself was at stake, and we did not stop to apply accounting methods. But "reconstruction" is in large degree a *business* matter, to be carried out by private enterprise, even though aided by government credit. Only a government can afford to make expenditures that will not pay—and governments cannot do it indefinitely. We may expect heavy buying to continue of food stuffs and things necessary for the life and health of the peoples of Europe, but the buying of materials to be used in construction, manufacturing, railroading, or other operations of that kind may be expected to proceed on a hand-to-mouth basis until prices have dropped sufficiently to induce business men to feel that a fairly stable level has been reached.

Forced Expansion of Bank Credit

(c) As much may be said for the notion that an organized policy of liberal lending on the part of American banks would prevent a decline in prices. The process of transition from war organization of industry to peace organization of industry will require the making of a great many loans that would not otherwise be required, and bank credit must be provided to put the transition through. But efforts by banks to control the expansions and contractions of credit are

much more likely to be successful when directed toward contraction than when directed toward expansion. Business men do not borrow and pay interest at the banks for amusement, and bankers do not make loans unless they see good prospects for the enterprises to be undertaken by the loans. American business men are not likely to be enthusiastic in borrowing and paying interest to support a falling market, nor would American banks be performing a useful public service in encouraging them to do so.

Much of the consumption demand of the American people, repressed by war time prices, will be effective as prices go lower. The past unsatisfied demand for food and day by day luxuries, for much clothing and many other things, is water which has gone under the mill. It will never affect future prices. But part of that past demand for clothing remains. And there is doubtless a large volume of deferred demand for household furnishings, pianos, automobiles, etc., which only awaits lower prices to become effective. With the release, moreover, of the current production of steel, copper, and other basic raw materials, now so largely devoted to war purposes, and with the release of large numbers of laborers now engaged in war work, a substantial amount of the most urgent construction work will begin, while with the decline in wages and prices of supplies, we may expect a very great volume of construction work to be promptly undertaken, keeping laborers and plants actively employed.

Falling Prices Stimulate Demand

There is nothing in the argument above to justify the suggestion that a period of slack industry must intervene. There is a tremendous volume of unsatisfied demand waiting for both labor and goods at lower prices. There is, in fact, a scale of demand prices both for labor and for goods at which supplies will be taken off the market as they come. A given manufacturer will take on ten more men if he can get them at a slight reduction of wages. If he can get them at a lower wage, he will take on twenty. If he can get them at a still lower wage, he will take on thirty. With copper and steel at

present prices, he will buy only moderate amounts; but with each drop in the prices of these commodities, he will increase the amounts which he is ready to purchase. As prices drop, the more urgent demands will be satisfied first, and then as prices drop still further, less urgent demands will be satisfied. When levels that are expected to be reasonably stable are reached, a very great volume of demand indeed will take up all supplies that come into the market. No arbitrary action should be taken to hasten this process, but none should be taken to impede it.

Stabilization by Public Expenditures

In the interests of active business, it is desirable that this relatively stable level should be speedily reached, and it is undesirable that palliative methods should be used unless actual unemployment appears. It should, however, be made definitely known that large scale plans for expenditures of the Federal Government, the States, and the municipalities are in readiness, in case unemployment should appear. But it is just as important that governments should curtail expenditure in times when prices are abnormally high and labor is working overtime, as that governments should increase their expenditure in times of unemployment. This use of governmental expenditure as a balance wheel does not mean that wasteful or useless work should be undertaken, merely to make jobs. It means rather that there is a great deal of necessary public work which can be done almost as well at one time as at another, and that the various grades of government should make orderly plans looking ahead through a ten-year cycle, so that they can take advantage of periods of relative depression, with a double gain: lower prices to the governments, and the prevention of unemployment. The great tension of the past two and a half years, with scarcity and high prices of labor and supplies, has led to the interruption of many public works, and has prevented many new ones from starting. *When* prices drop—as they must*—and *if* unemployment on a substantial scale should appear—as it may—then

*Discussed in booklet, "When Prices Drop," issued by the National Bank of Commerce in New York, November, 1918.

the various grades of the government should be prepared to take up the slack by useful public works.

A Buffer for Profits and Wages

American business need not be unduly apprehensive of the effects of falling prices and some slackening of business activity upon profits. Profits are, after all, a differential—what is left over after meeting costs. A general decline in prices means a general decline in costs. Moreover, with the forced draft under which American industry has been working for the past two or three years, there has necessarily come, in increasing degree, waste and inefficiency. Labor has been working overtime at high wages. It has been shifting rapidly from employment to employment—perhaps as great a factor in inefficiency as could be found. In some cases, it has not been amenable to shop discipline, and the employer has been largely helpless in the face of loafing and inefficiency. In other cases, protracted overtime work has lessened energy and efficiency. In some cases, laborers have lacked interest in the work in hand through the fact that they were constantly considering alternative employments. For these and other reasons, the labor force had become less efficient than it is in normal times. Wholly apart from a decline in wages, therefore, labor-costs per unit of output will decline, and it will not be necessary to reduce wages as fast as prices fall in order to break even on labor-costs.

Employers, moreover, driven by the pressure of new contracts, and harrassed by the multiplicity of details in new undertakings, have not been able to make use of their customary efficiency in bringing about economical production, while the large profits of the war period in many industries seemed to remove the necessity for the elimination of wastes.

With some relaxation of the tension under which both employers and laborers have been working, and with an increasing appreciation of the importance of economies and efficiency in production, we may expect wages to decline less rapidly than prices—especially desirable

in view of the fact that food prices are unlikely to decline greatly for some months.

Summary

In summary: Artificial control of business and prices should be dispensed with as rapidly as possible. At the earliest possible date, the business man should be free to make his plans and contracts with reference to accounting principles rather than under government direction. Neither price-fixing nor a forced expansion of credits can prevent the fall in prices which the return to peace conditions inevitably involves, nor would they be desirable if they could. If prices could be artificially sustained, it would merely mean a period of hesitation and increasing strain. As they decline naturally, however, we shall see the emergence of successive strata of demand which have been submerged by war-time prices, and the transition to peace-time price levels will be relatively painless. This will be particularly true since current stocks of goods are light, and since the relaxation of the forced draft under which production has been proceeding will make possible large economies and increasing efficiency which will make it unnecessary for either profits or wages to fall as rapidly as prices fall.

There remains, however, a large sphere for governmental action by ordinary commercial methods in the expansion of public expenditure of various kinds, as prices go lower and if unemployment should appear.

National Bank of Commerce in New York

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Statement of Condition

November 1, 1918

RESOURCES

Loans and Discounts	$307,609,266.34
Overdrafts, secured and unsecured	34,717.82
U. S. Certificates of Indebtedness and Liberty Bonds	96,560,090.37
Other Bonds and Securities	10,034,212.13
Stock of Federal Reserve Bank	1,200,000.00
U. S. and Other Bonds Borrowed	24,689,450.00
Bonds Loaned	50,000.00
Banking House	2,000,000.00
Due from Banks and Bankers	5,041,141.05
Checks and other cash items	3,262,846.30
Exchanges for Clearing House	49,315,517.36
Cash in Vault and Net Amount Due from Fed. Res. Bank	46,487,833.87
Interest Accrued	1,464,253.05
Customers' Obligations a/c Bank's Contingent Liability	1,440,000.00
Customers' Liability under Letters of Credit and Acceptances	42,210,499.09
	$591,399,827.38

LIABILITIES

Capital Stock paid in	$25,000,000.00
Surplus Fund	15,000,000.00
Undivided Profits, less expenses and taxes paid	9,376,660.45
Reserved for Taxes, etc.	3,096,833.25
Dividends unpaid	17,525.00
Letters of Credit	10,098,242.26
Acceptances executed for Customers	32,591,498.60
Deposits	379,835,997.64
U. S. and Other Bonds Borrowed	24,689,450.00
Unearned Discount	1,726,110.99
Bills Payable with the Federal Reserve Bank	88,000,000.00
Liabilities other than those above stated	1,967,509.19
	$591,399,827.38

NATIONAL BANK OF COMMERCE
1839
IN NEW YORK

MSH 21641

END OF
TITLE